

For Respondent: Jack Rubin, Assistant Counsel

## O P I N I O N

Appellants are husband and wife. Appellant Leonard Gordon is the sole proprietor of a food packaging business. He began the business in 1932 and under his direction it has developed into a substantial enterprise. During the years in question in this appeal he employed several hundred persons and his annual gross income from the business exceeded \$4,000,000. One source of income from the business was the sale of sacks in which dried fruits and beans were originally contained. The income from sales of sacks was used by Appellant Leonard Gordon to sustain himself and his family-during the early years when the enterprise was unprofitable. This income, supplemented by income from the sale of culls, continued to be used by him for family living-expenses through the years here in question.

• • •

Appeals of Leonard S. and Frances M. Gordon

returns in which they included the previously unreported income disclosed by the Internal Revenue Agents' investigation.

Appellants refused to file-amended State returns with the Franchise Tax Board. The proposed assessments were based on the additional income reported by the Appellants in their amended Federal returns. The original Federal returns reported net income of \$29,575.63 and \$7,920.71 for the years 1945 and 1946, respectively, for each Appellant. The amended Federal returns reported net income of \$39,507.62 and \$19,719.31 for the years 1945 and 1946, respectively, for each Appellant.

Appellant Leonard Gordon was indicted under Section 145(b) of the Internal Revenue Code of 1939 for filing fraudulent income tax returns with the Federal Government for the years 1945 and 1946, with the intent to evade tax. He pleaded not guilty and was tried and found guilty before the U. S. District Court for the Southern District of California, Central Division. The District Court's judgment was affirmed by the U. S. Court of Appeals, Ninth Circuit, in Gordon v. U. S., 202 Fed. 2d 596, and certiorari was denied by the U. S. Supreme Court, 345 U. S. 998.

Appellants attack the Franchise Tax Board's determination of the deficiencies in tax, but fail to offer any evidence of its incorrectness. The determination of the Franchise Tax Board is presumed correct and the burden of proof is on the taxpayer to show its incorrectness. (Todd v. McColgan, 89 Cal. App. 2d 509; Appeal of Pearl R. Blattenberger, Cal. St. Bd. of Equal., March 27, 1952 (CCH, 1 Cal. Tax Cases, Par. 200-148), (P-H, St. & Loc. Tax Serv., Cal., Par. 58,065).) Moreover, Appellants have admitted the receipt of the income 'in question in their amended Federal returns, upon which the Franchise Tax Board based its assessments. (Bedell v. Commissioner, 30 Fed. 2d 622; Times Tribune Co., 20 T. C. 449.) It is argued by the Appellants that the amended returns should not be considered as admissions because they were filed as a compromise. That contention is without merit. Although Appellants may have hoped to forestall further action by filing the amended returns, the Federal Government did not compromise in any respect. In the absence of evidence to the contrary, there is *no* reason to believe that Appellants reported in their amended Federal returns income which they did not receive.

The fraud penalties against Leonard Gordon were imposed under Section 13685 of the Revenue and Taxation Code. The burden of proving fraud falls upon the tax administrator. (Marchica v. State Board of Equalization, 107 Cal. App. 2d 501.) Direct evidence, however, is seldom available to prove fraud. Rather, it must be determined from the surrounding circumstances. (M. Rea Gano, 19 B.T.A. 518; Arlette Coat Co., 14 T. C. 751.)

Appeals of Leonard S. and Frances M. Gordon

As noted above, the deficiencies in tax resulted from the failure of Appellants to report income derived from sales of culls and used sacks. Unlike the revenue from other sources, the receipts from sales of culls and sacks were omitted from the books and records of the business, were regularly transmitted to Appellant Leonard Gordon and were by him used to defray the family living expenses. For the year 1945 these omitted receipts aggregated approximately \$20,000 and represented 25% of Appellants' total net income. In 1946 the aggregate of such receipts. ~~was~~ approximately \$24,000 and constituted 60% of Appellants' net income.

The substance of Mr. Gordon's explanation for any failure to enter receipts and withdrawals of income in his books and records, or the omission of any income from his tax returns, is that he left the bookkeeping and accounting entirely to his employees. He places on the employees the blame for the chaotic condition and general inadequacy of his books and records and disclaims any personal knowledge of the omission of sack and cull income from his records and tax returns. This explanation is weak and unconvincing. The failure over an extensive period to record any of the sales in this particular class, the substantial amounts of income thus omitted from the books, Mr. Gordon's intimate knowledge of and connection with the business and his personal receipt and use of the funds in question all lead inescapably to the conclusion that the omissions were not merely an incidental result of careless bookkeeping by his employees. In our opinion the record amply supports the Franchise Tax Board's determination that each of the deficiencies assessed against Leonard Gordon is due to fraud with intent to evade tax.

Appellants claim that the proposed assessments were barred by the period of limitations set up by Section 18586 of the Revenue and Taxation Code. However, the above section does not prescribe any time limitation if a fraudulent return has been filed. The returns filed by Leonard Gordon were fraudulent. In addition, Appellants executed waivers of the statute of limitations in favor of the Franchise Tax Board and pursuant to Section 18589 the period in which assessments could be proposed was extended to April 15, 1955. The notices of proposed assessments were issued on January 12, 1955.

Appeals of Leonard S. and Frances M. Gordon

# ORDER

Pursuant to the views expressed in the Opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of Leonard S. and Frances M. Gordon to proposed assessments of additional personal income tax against Leonard S. Gordon for the years 1945 and 1946 in the amounts of \$878.57 and \$1,635.33, respectively, including fraud penalties, and against Frances M. Gordon for the years 1945 and 1946 in the amounts of \$585.71 and \$1,090.22, respectively, be and the same is hereby modified as follows:

The assessments for the year 1946 against Leonard S. and Frances M. Gordon are to be reduced to \$332.40 and \$221.60, respectively. In all other respects the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 14th day of November,  
1960, by the State Board of Equalization.

John W. Lynch, Chairman

Geo. R. Reilly, Member

Paul R. Leake, Member

Richard Nevins, Member

\_\_\_\_\_, Member

ATTEST: Dixwell L. Pierce , Secretary